

MEMORANDUM

TO: Docket Control

FROM: Ernest G. Johnson
Director
Utilities Division

DATE: August 13, 2003

RE: STAFF REPORT ON CODE OF CONDUCT FOR THE GENERIC PROCEEDING
CONCERNING ELECTRIC RESTRUCTURING ISSUES, ET AL (DOCKET NO. E-
00000A-02-0051, E-01345A-01-0822, E-00000A-01-0630, AND E-01933A-02-0069)

Attached is the Staff Report on Code of Conduct required by Decision No. 65743 ("Track B").

EGJ:BEK:rdp

Originator: Barbara Keene

Attachment: Original and 19 Copies

Service List for: Generic Proceeding Concerning Electric Restructuring Issues, et al
Docket No. E-00000A-02-0051, E-01345A-01-0822, E-00000A-01-0630, AND E-01933A-02-0069

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**STAFF REPORT
UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION**

**GENERIC PROCEEDING CONCERNING
ELECTRIC RESTRUCTURING ISSUES, ET AL**

**DOCKET NO. E-00000A-02-0051, E-01345A-01-0822, E-00000A-01-0630, AND E-01933A-
02-0069**

CODE OF CONDUCT

AUGUST 13, 2003

STAFF ACKNOWLEDGMENT

The Staff Report on Code of Conduct for the Generic Proceeding Concerning Electric Restructuring Issues, Docket No. E-00000A-02-0051, E-01345A-01-0822, E-00000A-01-0630, and E-01933A-02-0069, was the responsibility of the Staff member listed below.

Barbara Keene
Public Utilities Analyst

EXECUTIVE SUMMARY
CODE OF CONDUCT
DOCKET NO. E-00000A-02-0051, E-01345A-01-0822, E-00000A-01-0630, AND E-01933A-02-0069

The Commission decided in Decision No. 65154 ("Track A") that the Codes of Conduct as adopted in Decision No. 62416 (April 3, 2000) and Decision No. 62767 (August 2, 2000) for Arizona Public Service ("APS") and Tucson Electric Power ("TEP"), respectively, must be revised in order to protect the public interest. APS and TEP were ordered to submit modifications as recommended by Staff to their Codes of Conduct. Such proposed revisions were to be filed with the Commission within 60 days of the effective date of Decision No. 65154 (September 10, 2003), with a hearing to be held as provided in A.A.C. R14-2-1616.

On November 12, 2002, TEP filed a letter with the Commission stating that neither TEP nor its parent, UniSource Energy, has a competitive electric service provider, a separate generation affiliate, or an affiliate involved in the marketing and trading of wholesale power. TEP stated that no modifications to TEP's Code of Conduct are necessary.

On November 12, 2003, APS filed modifications to its Code of Conduct.

The Detailed Staff Proposed Solicitation Process, adopted by Decision No. 65743 ("Track B"), recommended that all persons assigned to the solicitation by the utility be subject to a "standard of conduct" established for the purpose of maintaining a separation between the utility and any affiliated entity or person.

Decision No. 65743 directed Staff to file reports in these dockets on the Codes of Conduct previously filed by APS and TEP, within 60 days from the date of the Independent Monitor's final reports. The Staff Reports should include, but not be limited to, an analysis of the Standards of Conduct, their applicability to the respective Codes of Conduct filed by APS and TEP, and recommendations regarding their incorporation into the Codes of Conduct.

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Track A Decision

The Commission decided in Decision No. 65154 ("Track A") that the Codes of Conduct as adopted in Decision No. 62416 (April 3, 2000) and Decision No. 62767 (August 2, 2000) for Arizona Public Service ("APS") and Tucson Electric Power ("TEP"), respectively, must be revised in order to protect the public interest. The current Codes of Conduct need additional provisions and should cover an investor-owned electric utility regulated by the Commission and all affiliates in energy-related fields, including affiliates who sell power at wholesale.

APS and TEP were ordered to submit modifications as recommended by Staff to their Codes of Conduct. At a minimum, the Code of Conduct should address arm's length transactions; access to confidential information; cross-subsidization; preferential treatment to affiliates; joint employment and employee transfer issues; sharing of office space, equipment, and services; proprietary customer information; financing arrangements with affiliates; and conflicts of interest. Such proposed revisions were to be filed with the Commission within 60 days of the effective date of Decision No. 65154 (September 10, 2003), with a hearing to be held as provided in A.A.C. R14-2-1616.

On November 12, 2002, TEP filed a letter with the Commission stating that neither TEP nor its parent, UniSource Energy, has a competitive electric service provider, a separate generation affiliate, or an affiliate involved in the marketing and trading of wholesale power. TEP stated that no modifications to TEP's Code of Conduct are necessary.

On November 12, 2003, APS filed modifications to its Code of Conduct. See Schedule A for APS' current Code of Conduct and Schedule B for a red-lined version of APS' modified Code of Conduct.

Track B Decision

The Detailed Staff Proposed Solicitation Process, adopted by Decision No. 65743 ("Track B"), recommended that all persons assigned to the solicitation by the utility be subject to a "standard of conduct" established for the purpose of maintaining a separation between the utility and any affiliated entity or person. Persons who work for an affiliate, parent, or part of the utility involved in the sale or marketing of resources from generating assets owned by the utility should not participate in the solicitation preparation or evaluation of bids, or have any contact regarding the solicitation with any personnel assigned to conduct the solicitation, except on the same terms as any other bidder. In addition, a protocol should be established for all communications between the utility and all prospective bidders, regardless of whether they are affiliates or third party bidders. The protocol would prohibit the dissemination of any data to an affiliated person that are not provided to all other interested persons on equal terms and at the same time.

Decision No. 65743 directed Staff to file reports in these dockets on the Codes of Conduct previously filed by APS and TEP, within 60 days from the date of the Independent Monitor's final reports. The Independent Monitor's report was filed on June 13, 2003. The Staff

Reports should include, but not be limited to, an analysis of the Standards of Conduct, their applicability to the respective Codes of Conduct filed by APS and TEP, and recommendations regarding their incorporation into the Codes of Conduct.

The Commission set forth the following guidelines to clarify the Commission's position that no exercise of affiliate preferences would be tolerated in the solicitation process:

- APS shall treat non-affiliated generation equally in all respects with affiliated generation in the solicitation process. This requirement extends to any contractual arrangements associated with the bidding and procurement process that APS enters into with any affiliated entity involved in the solicitation and procurement process, including, but not limited to, access to gas capacity or transportation under APS' contract with El Paso Natural Gas Company.
- APS shall keep detailed records of any and all contacts with all non-APS entities, including employees of and contractors for its parent and all affiliates, regarding the initial and subsequent solicitations up through the time that the procurement process is complete. These records shall be maintained for the life of the longest contract, plus five years.
- Employees of and contractors for APS' parent and affiliates, who may be involved in the preparation of a bid in the solicitation process, shall not have contact with employees who will conduct the solicitation, concerning any business matter related to APS' parent or affiliates pertaining to the Track B solicitation.
- For the purposes of the solicitation and procurement, APS shall prohibit all personnel who provide advice to APS in the solicitation process from communicating with any personnel working for or contracted to APS' parent or affiliates who may be involved in the preparation of a bid in the solicitation process, concerning any business matter related to APS' parent or affiliates pertaining to the Track B solicitation.

See Schedule C for APS' current Standards of Conduct for the competitive procurement process.

Staff's Recommendation regarding TEP

Staff understands that TEP currently does not have an affiliate that sells wholesale or competitive retail electricity. However, TEP's parent, UniSource Energy, is nearing completion of the process to purchase Citizens Communications, Electric and Gas Divisions. Staff is not recommending a Code of Conduct between TEP and this new affiliate at this time because the affiliates are regulated by the Commission. Staff will monitor the situation and, if warranted, make a recommendation for a Code of Conduct in the future. If sometime in the future, TEP were to have an affiliate that sells wholesale or competitive retail electricity, then TEP should

file, within 60 days of the formation or acquisition of the affiliate, a revised Code of Conduct for Commission approval.

Staff's Proposed Modifications to APS' Code of Conduct.

A red-lined version of APS' Code of Conduct with Staff's proposed modifications is in Schedule 4. Many of APS' proposed modifications are included. The modifications are explained below by section.

Section I. - Definitions

APS added definitions for "Arm's Length Transaction," "Commission," "Competitive Electric Services," "Competitive Procurement Process," "Competitive Retail Activities," "Competitive Retail Affiliate," "Competitive Wholesale Services," "FERC," "Pinnacle West," and "Shared Services." Staff agrees with the addition of these terms. Staff modified the definition for "Shared Services" by removing "risk management," "energy risk management," and "law" and adding a sentence that indicates that these three items will not be included in "Shared Services." The Independent Monitor's report identified those two shared services as a continuing source of potential conflict during the solicitation.

APS deleted the definitions for "Competitive Activities," "Interim Competitive Activities," and "Same Terms." Staff agrees with the deletion of these terms because they are no longer needed.

APS modified the definitions for "Competitive Electric Affiliate," "Competitive Retail Services," "Confidential Customer Information," "Confidential Information," "Electric Competition Rules," "Extraordinary Circumstance," "Permitted Competitive Retail Activities," "Policies and Procedures," and "Third Party." Staff agrees with most of these modifications. Staff disagrees with APS' modifications to "Electric Competition Rules" to reference the rules in effect on the date of approval of the Code of Conduct instead of future amendments to the rules.

Staff added the definitions from the Standards of Conduct to this part of the Code of Conduct so that all of the definitions are in one place and conflicts can be eliminated. Staff modified the definition of "Commission Staff" to delete the phrase referring to the Competitive Procurement Process, making the definition applicable at all times and not just during the solicitation process, and modified "Procurement Team" to delete the team members because the team members could change over time.

"Competitive Procurement Process" is in both APS' modifications to the Code of Conduct and in the Standards of Conduct. Staff used a modified version of the definition in the Standards of Conduct. "Confidential Information" is in both the current Code of Conduct, as modified by APS and in the Standards of Conduct. Staff combined the two definitions. "Extraordinary Circumstance" is in both APS' modifications to the Code of Conduct and in the Standards of Conduct. Staff used the modified definition in the Code of Conduct and added "Arizona Independent Scheduling Administrator" before "AISA." "Shared Services" was proposed by

APS in the Code of Conduct and also is in the Standards of Conduct. Staff used the definition in the Code of Conduct.

Staff modified the definitions for "Noncompetitive Services" and "Standard Offer Service" to update the rule references.

Section II. – Applicability of Code of Conduct

APS modified this section to clarify and use updated terms. Staff sees no problems with APS' modifications.

Section III. – Treatment of Similarly Situated Persons

APS modified Paragraphs A, B, and C to clarify that the provisions refer to retail. APS also inserted a new Paragraph D regarding the Competitive Procurement Process. Staff sees no problems with the modifications.

Section IV. – Use of Confidential Customer Information

APS modified Paragraphs A and B to clarify that the provisions are regarding other parties engaged in Competitive Electric Services. APS also inserted new Paragraphs C and D regarding Competitive Electric Affiliates. Staff sees no problems with the modifications.

Section V. – Use of the Bill and Promotions within the Bill Envelope

APS modified this section to clarify that the provisions refer to retail. Staff concurs because this section is only applicable to retail.

Section VI. – Customer Telephone calls

No changes are proposed.

Section VII. – Prohibition on Suggestion of Utility Advantage

APS modified this section to update terms and clarify that some of the provisions refer to retail. Staff sees no problems with the modifications and inserted "of" after "purchase" in Paragraph F.

Section VIII. – Accounting for Costs

APS deleted this section and moved the provisions essentially to other locations in the Code of Conduct. It appears reasonable to Staff to have the provisions in more appropriate locations.

Section IX. – Reporting Requirements

APS renumbered this section to be Section VIII, added a due date to the filing requirements, changed the requirement regarding nontariffed transactions between affiliates to be summarized instead of detailed, added a report identifying transfers of employees between affiliates, and added a statement that information submitted would be treated in accordance with A.R.S. § 40-203. Staff sees no problems with the modifications, except with the reference to A.R.S. § 40-203. Staff changed the reference to A.R.S. § 40-204 as more appropriate because A.R.S. § 40-204 refers to reporting requirements.

Section X. – Separation Requirements

APS renumbered this section to be Section IX, added a provision about sharing equipment and facilities, reworded the provision regarding inspection of affiliates' books and records to be in accordance with A.A.C. R14-2-804.A, added a provision that common officers and directors shall not be permitted to participate in the Competitive Procurement Process, and made other minor revisions. Staff sees no problems with APS' modifications. However, Staff reviewed the Pinnacle West Organization Chart of April 4, 2003, that shows the officers of APS, Pinnacle West Energy Corporation, APS Energy Services, and Pinnacle West Capital Corporation. Some of the same officers hold positions in two or more affiliates. For example the Treasurer is the same officer in all four entities. This appears problematic. Officers and Directors may have different goals for the competitive and noncompetitive affiliates. Allowing joint officers and directors may lead to inappropriate decision-making and unfair cost shifting. Unless APS can provide information as to why this structure is justified, Staff recommends that a board member or corporate officer not serve both APS and a competitive electric affiliate.

Section XI. – Transfers of Goods and Services

APS renumbered this section to be Section X, added a provision requiring affiliate transactions to be arm's length, moved two revised paragraphs about subsidization here from Section VIII, added a provision that a governing body could permit an exception from a tariff, clarified the provision that APS would sell to affiliates nontariffed retail goods and services at the higher of cost or market, clarified that affiliates would sell nontariffed retail goods and services to APS at a price not to exceed market, and clarified that sales of competitive wholesale services among APS and its affiliates would be made in accordance with FERC and other applicable requirements. Staff concurs with these modifications but added a sentence to Paragraph D to require the direct and indirect allocators to be listed in the Policies and Procedures (P&Ps). Section XIV.B. provides for APS to notify the Commission of any revisions required to the P&Ps to address modifications to allocation methods or the allocators used in the P&Ps. Therefore, the allocators should be listed in the P&Ps.

Section XII. – Joint Marketing

APS renumbered this section to be Section XI and clarified that the section refers to retail. Staff sees no problems with these modifications.

Section XII. – Financing Arrangements

APS inserted this new section that provides for APS to comply with provisions of A.R.S. §§ 40-285; 40-301, et seq. and A.A.C. R14-2-804 with respect to financing arrangements. Staff sees no problems with this section.

Section XIII. – Dissemination, Education, and Compliance

APS added a provision that training on the Code of Conduct would be provided to employees of APS' affiliates, deleting reference to compliance with the Code of Conduct by APS' agents, and added a statement that unlawful anticompetitive behavior would be a violation of the Code of Conduct. Staff sees no problems with these modifications.

Section XIV – Procedures to Modify the Code of Conduct or P&Ps

APS moved two paragraphs here from Section VIII, but replaced annual filings of P&Ps updates with filing P&Ps updates when there are proposed revisions regarding allocation. Staff concurs because the modifications would reduce unnecessary paperwork.

Section XV. – Dispute Resolution

No changes were made to this section.

Standards of Conduct

Staff has attached the provisions of the Standards of Conduct to the Code of Conduct to make the Standards a permanent part of the Code of Conduct. Staff made the following modifications: deleted reference to inconsistency between Standards of Conduct and the Code of Conduct because the Standards are now incorporated into the Code, renumbered sections to account for deleted sections, deleted the Effective Date section so that the Standards would be effective with the rest of the Code of Conduct, added "in" in the last line of section II.C.2., changed the procedure to modify the Standards of Conduct because the Standards are now incorporated within the Code of Conduct, removed the time limit for Commission Staff audits because Staff has the right to audit at any time, eliminated the exceptions for legal counsel and attorney-client privilege in regard to communications between the Procurement Team and Bidders or Potential Bidders because there is no justification for such exceptions, and deleted the requirement for a password to access the Solicitation Web Site in order to eliminate a barrier to participation in the solicitation.

Staff Recommendations

Staff recommends that if, sometime in the future, TEP were to have an affiliate that sells wholesale or competitive retail electricity, then TEP should file, within 60 days of the formation or acquisition of the affiliate, a revised Code of Conduct for Commission approval.

Staff recommends that APS adopt the changes described above.